

## OBJECTIVE I OUTLINE

This outline sets forth the text from each of the slides in the section labeled “Objective I” in the power point considered at the meeting of the work group on October 29, 2018, specifically slides 20 through 32. This text is italicized.

In addition to the text from the power point, this outline incorporates changes and issues discussed at the meeting on October 29, which are highlighted in yellow. If there is no highlighted text inserted for a given slide, there was no substantive discussion.

This outline also incorporates changes and issues discussed at the meeting on November 14, when this outline and the yellow highlighted text was first considered. Changes and issues from the meeting on November 14 are highlighted in green.

### Slide 20: *Objective I*

*Propose legislation alternatives regarding conversion from a defined benefit plan to a defined contribution plan*

### Slide 21: *Current law regarding conversion*

*Nothing currently in statutes regarding how to do a conversion from one plan type to another. Current law does require identification of which type of plan (defined benefit or defined contribution):*

- *Articles or bylaws must state whether the relief association is a defined benefit plan or a defined contribution plan. (Section 424A.002)*

### Slides 22 through 32: *Proposal: Amend Chapter 424A to add a conversion process*

#### *Slides 22 and 23: Step 1*

*Board of trustees resolutions:*

- 1. Approving the conversion from defined benefit to defined contribution;*
- 2. Approving the conversion effective date (“CED”);*
- 3. Adopting a new defined contribution plan document, which specifies eligibility, annual allocations to accounts, vesting, distributions, ancillary benefits, and otherwise complies with Section 424A.016;*
- 4. Approving full (100%) vesting of all firefighters (actives and deferred) in their accrued benefit as of the CED, to the extent of the plan’s assets (as required by federal law);*
- 5. If plan assets are likely to exceed benefit liabilities on the CED:
  - *The board may approve an increase in the lump sum amount to reduce the surplus. The new lump sum amount cannot cause the funded status of the plan to fall below 100%,**

but can exceed the current statutory maximum. (*Lump sum amount need not comply with the \$10,000 statutory cap.*) The proposed legislation will state that the approval by the board of trustees of the relief association of an increase in the benefit level is conditional on there being sufficient assets to fund the increase. If, as of the date benefits are actually distributed to firefighters or, if elected, in direct rollovers, there are not sufficient assets to cover all benefit liabilities at the new higher benefit level, the benefit level will be decreased until assets equal liabilities. This new lower benefit level will be considered approved by the board of trustees without further action by the board.

Proposed legislation would state that the maximum lump sum amount, in section 424A.02, subd. 3, paragraph (d), does not apply to any increase in connection with a conversion where the relief association has a surplus over full funding.

The board may apply the increase to only active firefighters or to actives and deferred, notwithstanding any requirement in the statutes or relief association bylaws that applies the lump sum amount in effect as of the date that the firefighter left active service.

- *The board must approve a procedure for allocating the “surplus” (options covered in slides 27-31).*

6. A new section is needed to address less than 100% funded status: If the plan does not have enough assets to cover all accrued benefits, the board must approve resolutions stating how the shortfall will be funded or must adopt resolutions that reduce the lump sum amount to a level at which plan assets are sufficient to cover the cost of all accrued benefits. The work group discussed how a shortfall might be funded and determined that the only way this could happen is if the municipality agrees to fund the shortfall by making a contribution. Accordingly, staff proposes that the proposed legislation will note that the benefit level will need to be reduced by resolution of the board of trustees as needed so that assets are sufficient for benefit liabilities computed at the new benefit level, unless the city agrees to make a contribution sufficient to fund the shortfall.

The work group anticipates that one or more of these resolutions will require amendments to the bylaws of the relief association. Current law at sections 424A.02, subd. 10, 424A.092, subd. 6, and 424A.093, subd. 6, requires that a bylaws amendment be approved by the affiliated municipality if the plan does not have a “surplus over full funding” and the amendment “increases or otherwise affects the retirement coverage provided by or the service pensions or retirement benefits payable from the special fund....” Members of the work group suggested that proposed legislation include a provision that (1) requires municipal consent to a conversion, including all bylaws’ amendments related to the conversion, if the relief association does not have a surplus over full funding, or (2) if the relief association has a surplus over full funding, the requirement of municipal consent to bylaws amendments is waived. Proposed legislation would state that municipal consent is not required for any other bylaws amendments required by the conversion if the relief association plan has a surplus over fund funding. If it does not have a surplus over full funding, the bylaws amendments converting the plan to a DC plan will not take effect unless the municipality approves the bylaws amendments.

**Slide 24: Step 2**

The board of trustees determines the **estimated** value of each firefighter's fully vested accrued benefit as of the CED.

Method for determining **estimated** value may be either:

- (a) the method at Section 424A.092, subd. 2 (using the table which determines the accrued liability of each member's benefit for purposes of determining the plan's funded status); OR
- (b) as determined by an actuary retained by the relief association (actuary must meet the definition of "approved actuary" at Section 356.215, subd. 1(c)).

### Slide 25: Step 3

Board of trustees provides notice to firefighters (actives and deferred):

- At least **90** days in advance of the conversion effective date ("CED")
- Contents of the notice:
  1. inform that the lump sum amount has been increased (if approved by the board);
  2. explain that the plan is to be converted, the reasons for it, the conversion effective date, and the procedure to be followed, including fully vesting all members and the method for allocating any surplus;
  3. the **estimated** value of the firefighter's accrued benefit (fully vested) and the method used to calculate that value;
  4. contact information (phone and email) for one or more members of the board who will answer questions and provide a copy of the new DC plan document or a summary, if requested (or directions to a website for viewing and printing the plan document or summary);
  5. anything else? **The work group had no additional content requirements for the notice.**

As noted at the end of this outline, the notice requirements, along with the other requirements, will need to be expanded to address conversions (1) from a monthly defined benefit plan to a defined contribution plan and (2) from a defined contribution to a defined benefit plan (lump sum or monthly).

### Slide 26:

#### Step 4

Other notice or filing required? To Municipality? To State Auditor? **Yes, proposed legislation will require that the relief association provide notice to both the municipality (or municipalities) affiliated with the relief association and the State Auditor. Notice to include all of the above content requirements (items 1 through 4) and item 3 will be satisfied by providing a spreadsheet listing the name of each firefighter and the corresponding accrued benefit amount.**

#### Step 5

Take action to implement the conversion: Account established for each firefighter to which is recorded the value of the firefighter's fully vested accrued benefit as determined as of the CED.

Example:

A relief association defined benefit plan provides for a pension benefit equal to \$5,000 per year of service. A firefighter with 11 years of service is 64% vested in a pension benefit of \$55,000 (vested value = \$35,200). On the CED, the firefighter's benefit becomes 100% vested and the entire \$55,000 will be credited to a new account in the firefighter's name.

**Slides 27 through 31: Step 6**

*Deal with the surplus: the board allocates the surplus as approved in the conversion resolutions.*

*Options for allocating the surplus: Note: All of the following options should be included in the proposed legislation. Note: Proposed legislation would permit the relief association to decide whether the firefighters entitled to a share of the surplus are only "active" firefighters or will include "deferred" and/or "inactive" firefighters. "Deferred" will be defined as anybody who has accrued any benefit, i.e., had at least one year of service, even if the firefighter has not yet had five years of service, and "inactive" will be defined as firefighters who have not yet separated from service but are not meeting minimum service or training requirements or are on a leave of absence. (Does "leave of absence" need to be defined?)*

*I. Per capita method: Each active firefighter's account receives the same dollar amount.*

*OR*

*II. Service-based method: Each active firefighter's account receives a share of the surplus based on this ratio:*

$$\frac{\text{Firefighter's years of service}}{\text{Total years of service for all active firefighters}}$$

*OR*

*IIIA. Firefighter/municipality-sharing 2-step method:*

*First step: Municipality receives a share of the surplus based on this ratio:*

$$\frac{\text{Municipal contributions since [year]}}{\text{Total of fire state aid + municipal contributions since [same year]}}$$

*Second step: Remaining surplus is allocated to accounts of active firefighters using the per*

*capita, service-based, or another method.*

*OR*

*IIIB. Firefighter/municipality-sharing 2-step method:*

*First step: Municipality receives a share of the surplus based on the ratio in IIIA, but with directions on its use. Examples:*

- It must be contributed back to the plan over the next five years, for allocation to the accounts of future firefighters, or*
- It must be used to buy specific firefighting equipment, etc.*

*Second step: Remaining surplus is allocated to accounts of active firefighters using the per capita, service-based, or another method.*

*OR*

~~*IV. Other: Any other method approved by the board of trustees that does not discriminate in favor of the board of trustees.*~~ *Members of the work group suggested that this option not be included in the proposed legislation because it was unnecessary and too open-ended and it appeared that a consensus was reached. Accordingly, it will not be included in proposed legislation.*

*As already noted in slide 23, proposed legislation will require the board of trustees to approve a resolution that states how surplus will be allocated. The proposed legislation will permit the board to select any of the options set forth in slides 27-31, one of which permits the board nearly complete discretion in determining how to allocate surplus.*

**Step 7**

*Optional IRS filings? (See hand-out “Applicable Federal Law”)*

- ~~Relief association files the plan document of the terminated defined benefit plan with the IRS for a determination letter?~~
- ~~Relief association files the plan document of the new defined contribution plan with the IRS for a determination letter?~~

*Anything else?* The work group discussed whether this “best practice” should be included in the proposed legislation and the consensus appeared to be that this should not be included in the legislation, but could be included in informational materials produced by the State Auditor’s Office. Accordingly, it will not be included in proposed legislation.

IRS filings could be included in proposed legislation as options for providing comfort to the relief association and firefighters that the conversion did not adversely impact the federal tax-qualified status of the plan. The work group had no additional requirements or options.

The work group noted that the proposed legislation will also need to address:

- Conversions (1) from a monthly defined benefit plan to a defined contribution plan and (2) from a defined contribution to a defined benefit plan (lump sum or monthly). The process for these conversions will be as similar as possible to the process set forth above.
- Specifically identify the assistance that will need to be made available by the State Auditor, such as forms, checklists, and plan documents. Relief associations will be given the choice to use the State Auditor’s documents, etc., or work with their own actuary, accountant, and/or attorney.